

complaint

Mr L complains, with the help of a representative, about the advice he received from Mr B of The Financial Factory Ltd to move his pension provisions into a Self-Invested Pension Plan (SIPP), which was done to facilitate his investment in Harlequin. Mr L says that the advice did not meet regulatory requirements and that he should be compensated for this.

background

Between late 2011 and early 2012, Mr L transferred the monies from two pension plans into a SIPP on the recommendation of Mr B in his capacity as director of Financial Factory. He then invested £30,000 in Harlequin.

The suitability report, dated 31 October 2011, summarises Mr L's circumstances as follows:

- Married with four dependants
- Employed as a Managing Director
- Sufficient personal protection plans to cover all debt
- Two personal pension plans.

This section then goes onto to say that Mr L is not happy with the charges applied to his existing plans or their performance, so he is looking to move this to a SIPP. And, that Mr L has been presented an investment opportunity by a third party and requires advice on "*...how you can incorporate this within your future retirement planning.*"

The report also sets out that:

- Mr L has a good understanding of financial services products
- His main objective is to get advice on transferring his existing pension funds in order to invest in a "*commercial resort type investment within the Caribbean.*"
- Financial Factory had no involvement in the proposed investment
- The proposed investment is high risk and only suitable for experienced investors.

The report highlights, on a number of occasions, that the advice is restricted to recommending a suitable vehicle for making Mr L's chosen investment. Mr B's understanding of Harlequin is also set out but he clarified that this did not form part of the recommendation and Mr L should not view it as such. This goes through the basic characteristics of the investment and some of the risks involved. It also notes the involvement of The Property Factory Ltd but says that it also did not provide Mr L with advice on Harlequin.

The report gives a number of risk warnings about the Harlequin investment, including that it was high risk and that ultimately Mr L could lose all of his investment.

Mr L signed the SIPP application form on the same day.

Prior to this Mr B introduced Mr L to Harlequin in his capacity as director of Property Factory. Mr L had already signed a reservation form and the Harlequin contract as a result of this. Mr L also says that he attended a seminar about Harlequin with Mr B.

The SIPP was started in November 2011 and in December 2011 Mr L made a contribution of just over £3,000.

The process for transferring monies from his existing SIPP into his new SIPP started, but because of the failure of a property investment within his existing SIPP only just under £10,000 was transferred into his new SIPP. This happened at the end of February 2012. This sum was insufficient to cover the deposit on the Harlequin property.

On 6 March 2012, Mr B issued a further suitability report. This was very similar to the earlier report and included much of the same information but it recommended that Mr L move his other personal pension plan to his new SIPP to make the investment in Harlequin.

This switch was carried out on 14 March 2012 and the investment in Harlequin was made on 26 March 2012.

Mr L raised concerns about the investment with Mr B and, ultimately, complained about the advice he received. Mr B responded on behalf of Financial Factory. Mr B did not uphold the complaint, and said in summary that:

- The fact that Mr L could lose all of his investment was highlighted to him
- Mr L had acted as an agent for Property Factory and received payment for his own investment and for that of one other individual, who was his business partner
- He was well informed about the Harlequin investment and understood how it worked, including the risks involved
- He had known Mr L for around 28 years and had regular dealings with him through Mr L's business
- When Mr L approached Mr B for advice on finding a suitable SIPP, he had already made his own mind up about investing in Harlequin
- He classed Mr L as an experienced investor because he had acted as a sub-agent of Harlequin, he was the long standing director of his own business and had previously held a SIPP with which he had experienced problems
- No advice was given to Mr L in respect of Harlequin.

In light of the above, Financial Factory did not agree that any breach of duty of care had taken place.

Unhappy with this response Mr L referred his complaint to us.

Mr L's representative made submissions regarding his complaint, including:

- The advice given was in breach of Financial Factory's obligations under the relevant regulations and the Regulator's principles
- Mr L trusted Mr B not only as a regulated adviser but also as a long-standing business associate
- Mr L, having acted as an agent, does not take away from Financial Factory's obligation to provide suitable advice
- Mr L's client agreement with Financial Factory confirms that he would be treated as a retail client
- The undated sub-agent agreement says that Property Factory was solely responsible for introducing Mr L to Harlequin and was only briefly active
- The investment, other than Mr L's own, that he received commission for was made within weeks of his own

- Mr B introduced Mr L to Harlequin and is listed as the agent on Mr L's Harlequin Reservation Form, he then went on to advise on the SIPP, which is a clear conflict of interest
- Although Mr L did previously have a SIPP, this was taken out on the advice of another business rather than on Mr L's own initiative and knowledge
- Mr L did incur losses as a result of his previous SIPP investment and, as a result of this, he was more cautious about incurring losses on his remaining funds
- It is wrong to suggest that COBS 9.2.1R and COBS 9.2.2R allow an adviser to advise on the pension product without having a duty to assess the suitability of the underlying investment.

Our adjudicator reviewed the complaint and upheld it. He concluded that:

- There is a duty on the adviser to make a suitable recommendation to its client
- Financial Factory ought to have considered Mr L's investment objectives and the investment Mr L was interested in
- In this case, that would mean assessing the suitability of the SIPP and the Harlequin investment
- The risk warnings included in the suitability report did not fulfil this duty or meet its duty of care
- Financial Factory was aware that Mr L intended to invest the entirety of his remaining pension provisions in a high-risk unregulated investment despite having recently lost a significant amount in another investment
- It ought to have considered the overall proposition taking into account Mr L's wider circumstances
- Taking into account that the monies being transferred represented the entirety of Mr L's pension provision and that he did not appear to have any other significant investments or savings, Financial Factory should have recommended against the transfer and subsequent investment
- Mr L's having acted as an agent and his experience did not take away from Financial Factory's obligation to provide suitable advice or otherwise alleviate the adviser of his responsibilities
- Whilst Mr L was trained as a sub-agent of Harlequin, this did not make him a financial expert or provide him with the same level of knowledge as that of a reasonably competent and qualified financial adviser
- A significant conflict of interest was created by the fact that Mr B trained Mr L as a Harlequin sub agent, introduced him to Harlequin and acted as Mr L's financial adviser regarding the SIPP.
- Harlequin exposed investors to a significant amount of risk
- Mr B recommended a SIPP to allow Mr L to invest in an investment that was not suitable for him to invest his pension in
- Mr L would not have proceeded to transfer and invest in Harlequin had he been given suitable advice
- It is reasonable to hold Financial Factory responsible for the losses he has suffered as a result of moving his pensions to a SIPP and investing in Harlequin.

Financial Factory disagreed with our adjudicator's view, it said:

- It gave no advice regarding Harlequin
- Mr L was introduced to the investment by Mr B in his role as director of Property Factory

- Risk warnings were provided to Mr L, including that he could lose all of his investment
- Mr L was a sophisticated investor and an agent of Property Factory.

Because the Financial Factory disagreed, the complaint has been passed to me for review.

We spoke to Mr L about his recollections of the sale and the surrounding circumstances. In summary, he said that:

- He had an established relationship with Mr B, he had met him through his business and they had become friends
- He told Mr B about losing the money he had invested in a property investment through his SIPP and at this point Mr B introduced him to the Harlequin investment
- Mr L was aware that Mr B had two businesses but did not really distinguish between Property Factory and Financial Factory
- He did not think there was any likelihood of him losing his money because he was being advised by a friend
- In terms of all of the paperwork, he thinks he received most of it by post and was just told where to sign
- He does not remember much about becoming a sub-agent for Harlequin. He says it was just presented as an exciting opportunity to introduce people to the investment and that he did not receive any formal training
- He felt comfortable investing in Harlequin because he believed that Mr B had his best interests at heart.

my findings

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

What did Financial Factory do?

Financial Factory says that its advice was limited to finding a suitable SIPP because Mr L had already decided to invest in Harlequin.

The suitability reports described how the investment worked and provided some risk warnings – including that the investment was high risk and that ultimately Mr L could lose all of his money.

Mr L's basic circumstances and investment objectives were also set out within the suitability reports. I have set out the relevant details of these above. His main objective was said to be to transfer his existing pension funds in order to invest in a "*commercial resort type investment within the Caribbean.*"

What should Financial Factory have done?

The adviser was required to follow the relevant rules set out by the regulator. Of particular relevance I think are Conduct of Business Sourcebook (COBS) rules 2.1.1(acting honestly, fairly and professionally), 9.2.1(assessing suitability) and 9.2.2 (assessing suitability).

I think Financial Factory's obligations should be considered in light of the overarching principles of business, in particular principles 1 (*integrity*), 2 (*due skill, care and diligence*), 6 (*customers interests*) and 9 (*reasonable care*).

The Financial Conduct Authority (FCA) (previously the Financial Services Authority (FSA)) has undertaken a significant amount of work in this area and has provided some useful commentary that is of particular relevance to this type of scenario.

In 2013, the FCA (then FSA) issued an alert in relation to "*Advising on pension transfers with a view to investing pension monies into unregulated products through a SIPP*". This said, amongst other things, that:

“...The financial adviser does not give advice on the unregulated investment, and says it is only providing advice on a SIPP capable of holding the unregulated investment. Sometimes the regulated financial adviser also assists the customer to unlock monies held in other investments (e.g. other pension arrangements) so that the customer is able to invest in the unregulated investment.

Financial advisers using this advice model are under the mistaken impression that this process means they do not have to consider the unregulated investment as part of their advice to invest in the SIPP and that they only need to consider the suitability of the SIPP in the abstract. This is incorrect.

...It should be particularly clear to financial advisers that, where a customer seeks advice on a pension transfer in implementing a wider investment strategy, the advice on the pension transfer must take account of the overall investment strategy the customer is contemplating.”

I acknowledge that this alert came after Financial Factory's recommendation to Mr L but I don't think this means that it is not relevant to this complaint. I say this because the alert was issued because of issues that the regulator found when reviewing how some advisers were operating based on existing regulation. It was confirmation of the FCA's expectations of advisers in line with rules that had been in place before the transaction that is the subject of this complaint took place. So, I think that these findings are of equal relevance to Financial Factory's advice to Mr L in 2011 and 2012.

Taking into account all of the above, I don't think that Financial Factory met its obligations. The SIPP was just a wrapper and its suitability was linked to the source of the funds and the investment strategy to be employed within the SIPP. I think that it should have considered the suitability of the underlying investment as well as the SIPP, taking into account Mr L's overall circumstances, including his financial circumstances, attitude to risk, capacity for loss and his existing pension arrangements.

What would suitable advice have been?

Whilst Financial Factory only provided advice in relation to the SIPP, it did describe the investment and give risk warnings about its nature. I have thought about the contents of these risk warnings and the effect these had on the transaction. The description and the risk warnings were detailed but providing information is not the same as giving advice. I am not sure how this information was presented to Mr L outside of the report or if he would have had time to read and digest this information given that the SIPP application form was signed on the same day.

Mr L says he was simply sent the paperwork and told where to sign. Also, given that the overall outcome of the report was a recommendation for a suitable SIPP to facilitate the investment in Harlequin, and confirmation that no advice was being given about Harlequin, I would question the effect that these warnings would have had.

Harlequin was a high-risk investment. It was unregulated and esoteric. Harlequin had no track record, and there was a possibility the project could fail and Mr L's investment be lost. The investment also involved Mr L only paying a deposit of 30% of the purchase price of the property, but being committed to paying the balance and securing borrowing to do that.

Mr B did not classify Mr L's attitude to risk within the report on the basis that he had already chosen the investment he would like to make. So, I have had to think about the suitability of the transfer based on what I know about Mr L's circumstances at the time of the advice.

Financial Factory has said that Mr L was an experienced investor. I have taken into account that he had previously invested in a property investment that lost money. And, that he had been trained as a sub-agent for Harlequin by Property Factory. In this particular case, neither of these things allows me to conclude that Mr L was an experienced investor. It is my understanding that another adviser's advice led to the previous investment in property. Mr L says that because of this he was keen to preserve and improve his pension provision.

I don't know what training Mr L received, he has told us that he attended a seminar with Mr B about Harlequin. I think this is likely to have focused on the benefits of Harlequin rather than the risks involved with this type of investment. I have not seen enough to conclude that Mr L had a higher than normal general understanding of pensions and investments. In any case, I don't think that this makes investing the vast majority of his pension provisions in a high-risk investment suitable.

Financial Factory also mentioned that Mr L had been the director of his own business for some time. I don't think that running his own business, which had nothing to do with financial services, would have given Mr L any specialist knowledge of pensions/complex investments or that it made this course of action any more suitable.

Pensions are intended to provide an income in retirement. Based on what I've seen, at the time of the advice, Mr L's pension provisions were relatively modest and just over three quarters of it was invested into Harlequin. Had Financial Factory reviewed the suitability of the underlying investment and the SIPP, it ought to have concluded that this was not a suitable course of action for Mr L to take. Having done so, it ought to have unequivocally advised against moving his pensions to a SIPP in order to invest in Harlequin.

In this particular case, I would also question whether Mr B should have given advice in relation to the SIPP at all. I say this because he had promoted Harlequin to Mr L in his other capacity (as director of Property Financial and as an agent of Harlequin) and I am not satisfied that he could then reasonably give independent advice to Mr L regarding the same transaction, as this created a significant conflict of interest.

What would have happened if suitable advice had been given?

I have thought carefully about the involvement of Property Factory in terms of what Mr L would have done had he received suitable advice. Sometimes an investor's relationship with the third party introducer is such that it is likely that they would have gone ahead with the investment even if a regulated adviser told them not to. I don't think that this reasoning could apply in this case because the third party and the adviser were the same person.

Mr L had already signed up for Harlequin at the time of this advice and it is likely that he would have lost any reservation fee he paid. This likely would have factored in Mr L's decision. But I don't think that this would have been sufficient for him to ignore advice from a regulated adviser who he trusted.

Mr L did sign up to be a sub-agent for Property Factory and to introduce people to Harlequin. It appears that this agreement was short lived and that Mr L only introduced himself and his business partner to Harlequin. I think the effect of this needs to be considered in light of the fact that because Mr L did not have any specialist investment or pensions knowledge, his understanding of the investment would have come from Mr B and marketing materials provided by Harlequin. It is unlikely that Mr L would have decided to become a Harlequin agent if Mr B had told him that the investment was not suitable for investors like him. So, I don't think that this is similar to situations where someone has promoted Harlequin based on their own knowledge and expertise – and, therefore is likely to have had the confidence in their own knowledge to disregard advice from a regulated adviser. I think that Mr L would reasonably have seen Mr B as the expert and would have put a lot of weight on his opinion.

Mr L did receive some commission for his investment in Harlequin. So, there was a cash incentive for Mr L to go ahead with the investment. There is no evidence that Mr L had a significant need for this sum of money. Or, that it would otherwise have been enough of an incentive for Mr L to disregard advice that the proposed course of action was not suitable.

Mr L and Mr B had a long-standing relationship and, based on what I've seen, I think Mr L trusted Mr B to advise him on financial matters. And, I am satisfied that it is most likely that if Mr B, in his capacity as director of Property Factory had told Mr L that moving his pension to a SIPP and investing in Harlequin was wholly unsuitable, Mr L would not have gone ahead with it.

fair compensation

In assessing what would be fair compensation, I consider that my aim should be to put Mr L as close to the position he would probably now be in if he had not been given unsuitable advice.

I take the view that Mr L would have invested differently. It is not possible to say *precisely* what he would have done differently. But I am satisfied that what I have set out below is fair and reasonable given Mr L's circumstances and objectives when he invested.

There are also a number of possibilities and unknown factors in making an award. The involvement of third parties – the SIPP provider and Harlequin Property – means much of this is beyond this service or the business' control.

All the variables are unknown and each may have an impact on the extent of any award this service may make. The facts suggest it's unlikely that the property will be completed and unlikely that the contract and any future payments would be enforceable – but I can't be certain of that.

While it's complicated to put Mr L back in the position he would have been in if suitable advice had been given, I think it's fair that Mr L is compensated now. I don't think we should wait and determine each and every possibility before making an award. What is set out below is a fair way of achieving this.

what should Financial Factory do?

To compensate Mr L fairly, Financial Factory must:

- Compare the performance of Mr L's investment with that of the benchmark shown below and pay the difference between the *fair value* and the *actual value* of the investment. If the *actual value* is greater than the *fair value*, no compensation is payable.

Financial Factory should also pay interest as set out below.

If there is a loss, Financial Factory should pay such amount as may be required into Mr L's pension plan, allowing for any available tax relief and/or costs, to increase the pension plan value by the total amount of the compensation and any interest.

If Financial Factory is unable to pay the total amount into Mr L's pension plan, it should pay that amount direct to him. But had it been possible to pay into the plan, it would have provided a taxable income. Therefore the total amount should be reduced to *notionally* allow for any income tax that would otherwise have been paid.

The *notional* allowance should be calculated using Mr L's marginal rate of tax at retirement.

For example, if Mr L is likely to be a basic rate taxpayer in retirement, the *notional* allowance would equate to a reduction in the total amount equivalent to the current basic rate of tax. However, if Mr L would have been able to take a tax free lump sum, the *notional* allowance should be applied to 75% of the total amount.

- Pay Mr L £500 for the trouble and upset caused by the loss of the majority of his pension provision. I say this because, I think that the apparent loss of almost all of pension provision would have caused Mr L a significant amount of worry and concern over how he would replenish his retirement provision.

Income tax may be payable on any interest awarded.

investment name	status	benchmark	from ("start date")	to ("end date")	additional interest
Harlequin	mixed	FTSE UK Private Investors Income Total Return Index	date of investment	date of my decision	8% simple per year from date of decision to date of settlement (if compensation is not paid within 28 days of the business being notified of acceptance)

actual value

This means the actual amount payable from the investment at the end date.

My aim is to return Mr L to the position he would have been in but for the unsuitable advice. This is complicated where an investment is illiquid (meaning it could not be readily sold on the open market) as in this case. It would be difficult to know the *actual value* of the investment. In such a case the *actual value* should be assumed to be nil to arrive at fair compensation. Financial Factory should take ownership of the illiquid investment by paying a commercial value acceptable to the pension provider. This amount should be deducted from the total payable to Mr L and the balance be paid as I set out above.

If Financial Factory is unwilling or unable to purchase the investment the *actual value* should be assumed to be nil for the purpose of calculation. Financial Factory may wish to require that Mr L provides an undertaking to pay Financial Factory any amount he may receive from the investment in the future.

fair value

This is what the investment would have been worth at the end date had it produced a return using the benchmark.

Any additional sum paid into the investment should be added to the *fair value* calculation from the point in time when it was actually paid in.

Because Mr L received commission for his investment in Harlequin, this has to be taken into account. The amount he received in commission, which I understand to be £3,000, should be deducted from the pension fund used for the purposes of the redress calculation at the outset.

payment of any future fees owed to the current SIPP for the next five years

Had Financial Factory given suitable advice I don't think Mr L's current SIPP would exist. It's not fair that Mr L continues to pay the annual SIPP fees if it can't be closed.

Ideally, Financial Factory should take over the investment to allow the SIPP to be closed. This is the fairest way of putting Mr L back in the position he would have been in. But the ownership of the Harlequin Property investment can't currently be transferred. It's likely that will change at some point, but I don't know when that will be – there are a number of uncertainties.

So, to provide certainty to all parties, I think it's fair that Financial Factory pays Mr L an upfront lump sum equivalent to five years' worth of SIPP fees (calculated using the previous year's fees), or undertakes to cover the fees that fall due during the next five years. This should provide a reasonable period for things to be worked out so the SIPP can be closed.

In return for the compensation set out above, Financial Factory may ask Mr L to provide an undertaking to give it the net amount of any payment he may receive from the Harlequin Property investment in that five year period, as well as any other payment he may receive from any party as a result of the investment. That undertaking should allow for the effect of any tax and charges on the amount he may receive. Financial Factory will need to meet any costs in drawing up this undertaking. If it asks Mr L to provide an undertaking, payment of the compensation awarded by this decision may be dependent upon provision of that undertaking.

If, after five years, Financial Factory wants to keep the SIPP open, and to maintain an undertaking for any future payments under the Harlequin Property investment, it must agree to pay any further future SIPP fees. If Financial Factory fails to pay the SIPP fees, Mr L should then have the option of trying to cancel the Harlequin Property contract to enable the SIPP to be closed.

In addition, Financial Factory is entitled to take, if it wishes, an assignment from Mr L of any claim Mr L may have against any third parties in relation to this pension transfer and Harlequin Property investment. If Financial Factory chooses to take an assignment of rights, it must be affected before payment of compensation is made. Financial Factory must first provide a draft of the assignment to Mr L for his consideration and agreement.

The SIPP has paid a deposit under a contract with Harlequin Property. Mr L has agreed for the SIPP to pay the remainder of the purchase price under that contract. Those sums have not yet been paid, so no further loss has been suffered. However, if the property is completed, Harlequin Property could require those payments to be made. I think it's unlikely that the property will be completed, so I think it's unlikely there will be further loss. But there might be. Mr L needs to understand this, and that he won't be able to bring a further complaint to us if this contract is called upon.

why is this remedy suitable?

I have decided on this method of compensation because:

- Mr L wanted capital growth and was willing to accept some investment risk.
- The FTSE UK Private Investors Income total return index (prior to 1 March 2017, the FTSE WMA Stock Market Income total return index) is a mix of diversified indices representing different asset classes, mainly UK equities and government bonds. It would be a fair measure for someone who was prepared to take some risk to get a higher return.

- Although it is called income index, the mix and diversification provided within the index is close enough to allow me to use it as a reasonable measure of comparison given Mr L's circumstances and risk attitude.
- Mr L has not yet used his pension plan to purchase an annuity.

my final decision

I uphold the complaint. My decision is that The Financial Factory Ltd should pay the amount calculated as set out above.

The Financial Factory Ltd should provide details of its calculation to Mr L in a clear, simple format.

Under the rules of the Financial Ombudsman Service, I am required to ask Mr L either to accept or reject my decision before 12 October 2017.

Nicola Curnow
ombudsman